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Technical Bulletins: FICA Tax Savings Available to Cities

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technical bulletin

Municipal Technical Advisory Service
Institute for Public Service, The University of Tennessee
In cooperation with the Tennessee Municipal League

January 11, 1979

FICA TAX SAVINGS AVAILABLE TO CITIES

Cities can save some money by assuming payment of the employees' share of the FICA tax, and each employee's pay can be adjusted so that there is no adverse effect on his/her salary. In fact, the employee's salary subject to federal income tax will be slightly less with no decrease in take-home pay. This can best be accomplished by pay adjustments at the time of across-the-board annual salary increases, as illustrated by the following example:

<u>Customary Method</u>		<u>Alternate Method</u>	
Current salary	\$10,000.00	Current salary	\$10,000.00
Plus 7% increase	700.00	Plus .4909% increase	44.09
New salary (taxable income)	10,700.00	New salary	10,044.09
Less employee's FICA tax*	655.91	Less employee's FICA tax	-0-
Salary after FICA tax	10,044.09	Salary after FICA tax	10,044.09
Employer's cost:		Employer's cost:	
New salary	10,700.00	New salary	10,044.09
Plus employer's FICA tax*	655.91	Plus employee's FICA tax	615.70
	11,355.91	Plus employer's FICA tax	615.70
			11,275.49

*6.13% in 1979

Employer's cost under customary method	\$11,355.91
Employer's cost under alternate method	11,275.49
Savings to employer	80.42

Income taxable to employee:	
New salary	\$10,044.09
Employee's FICA tax	615.70
	10,659.79

The following is quoted from IRS Revenue Ruling 74-75:

Section 3121 (a)(6) of the Federal Insurance Contributions Act provides that the term "wages" for purposes of that Act, does not include "the payment by an employer (without deduction from the remuneration of the employee)--(A) of the tax imposed upon an employee under section 3101" Therefore, for purposes of the Federal Insurance Contributions Act, no additional tax was applicable to the employee tax liability incurred by the employer for the employee.

Revenue Ruling 74-75 also held that an employee's FICA tax, when paid by the employer, must be reported as income to the employee.

A city with a substantial number of employees may find that the aggregate savings, though small for each employee, would be sufficient to warrant making this change. Savings for higher-salaried employees would, of course, be larger than in the foregoing example. The policy would need to be established by action of the governing body (ordinance or resolution), after which it would be a matter of mechanics and arithmetic to determine salary and tax amounts for each employee (computers easily should handle this process). As mentioned at the outset, the strategic time to make such a change is when annual salary increases are being made.

Municipal Technical Advisory Service
The University of Tennessee
Knoxville, TN 37916

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